Supreme Court, U.S.
FILED
JUL 6 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-1946

In the Supreme Court of the United States

OCTOBER TERM, 1989

GERALDINE TEMPLIN, PETITIONER

v.

LYNNETTE R. WEISGRAM, SUBSTITUTE TRUSTEE, AND FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that, where the Federal Deposit Insurance Corporation (FDIC) purchased from a failed bank a deed of trust that was valid on its face, 12 U.S.C. 1823(e) precluded petitioner from defeating the FDIC's enforcement of the deed of trust on the basis of a secret oral agreement that purported to alter the deed of trust.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 15-19) is reported at 867 F.2d 240. The opinion of the district court (Pet. App. 21-23) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 8, 1989. The petition for a writ of certiorari was filed on June 5, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

In 1985, petitioner and her then-husband, Billy Bob Biggs, executed a warranty deed conveying their home to Robert M. Nelson for $104,000. Nelson took out a loan in

the amount of the purchase price from the now-insolvent First National Bank of Irving, Texas (Bank); he made out a note to the Bank in that amount and, to secure the note, also executed a deed of trust that pledged the property as collateral. The warranty deed was recorded in the Deed Records of Dallas County.

Despite appearances, this transaction was actually a sham designed not to transfer the property but, instead, merely to enable petitioner and Biggs to borrow money against their home. The "simulated" sale was a means of circumventing Article 16, § 50, of the Texas Constitution, which prohibits the use of homestead property as security for all but certain specified types of loans, including purchase money mortgages. Pursuant to an oral agreement between the Bank, Nelson, and petitioner and Biggs, the Bank paid the $104,000 directly to Biggs and petitioner (minus the amount of a debt Biggs owed to the Bank), Nelson reconveyed the property back to petitioner and Biggs, who continued to live in the house, and Biggs agreed to pay off the note. This oral agreement was nowhere reflected in Nelson's note, in the deed of trust, or in any other records of the Bank.

When the Bank failed in April 1986, the Nelson note was in default. As part of a purchase and assumption transaction undertaken when the Bank was declared insolvent, the FDIC, in its corporate capacity, acquired the note and the deed of trust.[1] The FDIC then initiated

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[1] On April 24, 1986, the Comptroller of the Currency declared the bank insolvent and appointed the FDIC as receiver. As such the FDIC entered into a purchase and assumption transaction with another solvent bank, selling certain assets and liabilities to that institution. The receiver sold the remaining assets, including the Nelson note and the deed of trust, to the FDIC in its corporate capacity. See 12 U.S.C. 1823(e); *Langley* v. *FDIC*, 108 S. Ct. 396, 400 (1987); *Gunter* v.

foreclosure proceedings according to the terms of the deed of trust executed by Nelson.

Petitioner filed suit in state court to restrain the foreclosure, arguing that, under the homestead provision of the Texas Constitution, the pretended sale of her home was void and that the recorded deed of trust was therefore invalid. The FDIC removed the case to federal district court, which granted summary judgment in favor of the FDIC. The court held that 12 U.S.C. 1823(e) and the doctrine of *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), precluded petitioner from relying on evidence of her oral side agreement to defeat the FDIC's interest in the deed of trust, which was regular and valid on its face. Relying on this Court's decision in *Langley* v. *FDIC*, 108 S. Ct. 396 (1987), the court explained that allowing petitioner to rely on her agreement, which was nowhere in evidence in the Bank's records, would defeat Section 1823(e)'s purposes of ensuring that bank examiners are able to rely on a bank's records to determine its worth and that senior bank officials can give mature consideration to bank agreements. Pet. App. 21-23.

The court of appeals affirmed. Pet. App. 15-19. Relying on *Langley*, the court pointed out that one of Section 1823(e)'s central goals was to "protect the FDIC from undisclosed 'secret' agreements that undermine the value of a bank's assets" (Pet. App. 17) and that petitioner's secret agreement was "quintessentially the type of conduct against which § 1823(e) was designed to protect the FDIC" (*id.* at 18 n.2).[2] The court explained (*id.* at 18) that peti-

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Hutcheson, 674 F.2d 862, 865-866 (11th Cir.), cert. denied, 459 U.S. 826 (1982).

[2] The court added: "On the facts as alleged, one cannot help but reach the conclusion that the loan was made through a simulated sale solely to deceive federal and state bank regulators. All parties knew

tioner was seeking to defeat the FDIC's rights under the deed of trust based on her secret agreement, in contravention of the express language of Section 1823(e), which declares that "[n]o agreement which tends to diminish or defeat the right, title or interest of the [FDIC] in [an] asset acquired by it * * * shall be valid against the [FDIC]" unless, among other things, the agreement is "in writing."

The court rejected petitioner's claim that the deed of trust was not an asset in which the FDIC had any interest because it was void under the Texas Constitution's homestead provision. Petitioner relied on this Court's statement in *Langley* (108 S. Ct. at 402) that "the real defense of fraud in the factum * * * would take the instrument out of § 1823(e), because it would render the instrument entirely void." The court pointed out that the statement was dictum, as *Langley* involved a claim of fraud in the inducement. In any event, the court explained, the quoted statement did not deal with, and Section 1823(e) clearly covered, situations in which a party seeks to defeat the FDIC's interest in an asset by relying on a wholly voluntary side agreement that, if undisclosed, leaves the Bank's records misleading to bank regulators. The court concluded that entering into such an agreement, as petitioner did, "is without doubt precisely the type of conduct to which the section was meant to apply." Pet. App. 18. See *id.* at 18-19.

ARGUMENT

Petitioner challenges the court of appeals' ruling that, under 12 U.S.C. 1823(e), she was not entitled to defeat en-

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that the transaction was invalid under the Texas Constitution and therefore would be unenforceable; on the bank's records, however, the note and deed of trust executed by Nelson would likely lead bank examiners to believe that the instruments did not run afoul of state law and were therefore valid assets." Pet. App. 18 n.2.

forcement of the facially valid deed of trust based on the secret, oral agreement she voluntarily entered into to mask the true character of the transaction. Petitioner does not contend that the court's decision is inconsistent with any decision of any other court of appeals; nor does she contend that the decision presents an issue of general importance.[3] She contends simply that the decision applies Section 1823(e) incorrectly and in a manner that is inconsistent with this Court's decision in *Langley*. That contention is meritless.

As the court of appeals held, petitioner seeks to do precisely what Section 1823(e), in its language and purpose, forbids—to defeat the FDIC's ability to enforce a facially valid asset on the basis of a secret, voluntary, oral agreement. Thus, petitioner asserts as "valid against the [FDIC]" an agreement that does not meet Section 1823(e)'s requirements (it is not in writing and is not an official record of the Bank) but that, if valid against the FDIC, would "diminish or defeat the right, title or interest of the [FDIC] in [an] asset acquired by [the FDIC]" (namely, the deed of trust). Petitioner's claim directly conflicts with a central purpose of Section 1823(e)—to enable the FDIC "to rely on a bank's records in evaluating the worth of the bank's assets," a process that, during purchase and assumption transactions such as occurred in this case, must be carried out with great speed. *Langley*, 108 S. Ct. at 401. "Neither the FDIC nor state banking authorities would be able to make reliable evaluations if bank records contained seemingly unqualified notes that are in fact subject to undisclosed conditions." *Ibid.* Allowing petitioner's secret agreement to defeat enforcement of the facially valid deed of trust in the Bank's records would produce precisely that result.

[3] Indeed, petitioner does not identify any other state whose law contains a homestead provision like that of Texas.

Petitioner nevertheless contends that the Bank did not acquire any "right, title or interest" in the deed of trust because, under the homestead provision of the Texas Constitution, the deed of trust was void. In this Court, as in the court of appeals, petitioner relies solely on a statement from the *Langley* decision to the effect that the defense of fraud in the factum "would take the instrument out of § 1823(e)" (108 S. Ct. at 402). That statement, however, does not require recognition of petitioner's defense.

First, the *Langley* statement concerns only the defense of fraud in the factum, which was not at issue in that case and has never been claimed by petitioner. Accordingly, the court of appeals' ruling is not inconsistent with a holding of the Court in *Langley* or even with dictum addressed to the particular defense asserted by petitioner. Moreover, understood in context, the statement does not establish the general proposition that petitioner suggests—namely, that any defense that would render an instrument void under state law takes the instrument outside Section 1823(e). Instead, the statement says only that the defense of fraud in the factum would render the instrument void in a way that would leave the FDIC with no "right, title or interest" within the meaning of Section 1823(e).[4]

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[4] The "right, title or interest" language of Section 1823(e) may not be the most obvious source for permitting a defense of fraud in the factum. A more natural reason why that defense is outside the reach of Section 1823(e)'s language may simply be that the signatory is not asserting a valid side "agreement"—a separate understanding or representation—as the ground for defeating the FDIC's interest in the instrument. He is asserting merely that he never knowingly and with understanding gave his assent to the terms of the document on which his signature appears. Accordingly, a recognition that the defense of fraud in the factum is not barred by Section 1823(e) does not depend on *Langley*'s reliance on the "right, title or interest" language. As explained in text, however, even if it does, the present case is different.

Furthermore, consideration of the clear purposes of Section 1823(e) suggests that fraud in the factum should produce a quite different result under that provision from that produced by petitioner's defense (even if petitioner's defense would render Nelson's deed of trust void under state law). The defense of fraud in the factum requires that the signatory to the instrument have no reasonable opportunity to know of the true character or essential terms of the instrument before signing it—and hence no reasonable opportunity to avoid being bound.[5] When the effect of enforcing a written instrument would be to bind an innocent victim of that kind of fraud, it is reasonable to construe Section 1823(e) to preclude the FDIC from acquiring any "right, title or interest."[6] In contrast, petitioner's defense, far from involving any lack of opportunity to protect herself, is based on a wholly voluntary side agreement made for the purpose of rendering misleading to third parties a written instrument that was fully known and understood by petitioner. In those circumstances, there is no reason to limit the natural meaning of Section 1823(e), under which the FDIC acquired a "right, title or interest" in the deed of trust when it purchased it from the failed Bank. Indeed, as

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[5] See U.C.C. § 3-305(2)(c) (1977); Restatement (Second) of Contracts § 163 (1981); 1 J. White & R. Summers, *Uniform Commercial Code* § 14-9, at 731-732 (3d ed. 1988). The sentence from *Langley* that petitioner relies on (108 S. Ct. at 402) cites the U.C.C. provision in referring to the defense of fraud in the factum.

[6] That *Langley*'s discussion of an exception for fraud in the factum was based on the lack of opportunity for self-protection may also be indicated by its citation of a portion of the FDIC's oral argument in that case (Tr. 24-25, 27-30) in support of permitting the fraud in the factum defense under Section 1823(e). In the cited passages, the FDIC did not argue that the test was whether the instrument was void under state law, but, rather, advanced the self-protection rationale for recognizing that Section 1823(e) does not preclude a defense of fraud in the factum.

the court of appeals observed (Pet. App. 18 & n.2), petitioner's conduct is precisely the sort against which Section 1823(e) was designed to protect the FDIC. Accordingly, the court of appeals was correct in holding that Section 1823(e) bars petitioner's attempt to defeat the FDIC's enforcement of its deed of trust on the basis of a secret side agreement.

In any event, even if any instrument that is void under state law were outside the coverage of Section 1823(e), it is by no means clear that the deed of trust—given by Nelson to the Bank and later purchased by the FDIC—would actually be void under Texas law. Notwithstanding the generally rigid homestead provision of the Texas Constitution, parties who participate in bogus transactions may be estopped under Texas law from benefiting from their own wrongdoing and prevailing against innocent third parties. See, *e.g.*, *National Bond & Mortgage Corp.* v. *Davis*, 60 S.W.2d 429, 434 (Tex. Comm'n App. 1933) ("it was never intended by the framers of the Constitution that the homestead law should be used to defeat the rights of an innocent third party, who, in good faith, without notice, for a valuable consideration, has acquired valid liens against the property"); *Rabbe* v. *Federal Land Bank*, 161 S W.2d 1097 (Tex. Civ. App. 1942) (when a husband and wife execute a deed conveying property and the deed is properly recorded, the parties are estopped from declaring the vendors' lien void because the deed conveyed homestead property as part of a simulated transaction); *Goodrich* v. *Second Nat'l Bank*, 151 S.W.2d 276 (Tex. Civ. App. 1941). See also *Collier* v. *Union Central Life Ins. Co.*, 100 F.2d 411, 413-414 (5th Cir. 1938) (holding Texas decisions "vigorous and unswerving" in protecting innocent lenders by estopping borrowers from asserting homestead rights on collateralized property after procuring a loan through

"misrepresentation, fraud, or other machination" concerning the property's homestead character).[7]

Finally, the federal common law doctrine of *D'Oench, Duhme, supra,* independently supports the court's result and bolsters the court of appeals' application of Section 1823(e). *D'Oench, Duhme* held that the FDIC, having acquired a note from a failed bank, was immune from a defense asserted by the maker of the note, where the maker had, by entering into a secret agreement with the bank, "lent himself to a scheme or arrangement whereby the banking authority * * * was likely to be misled." 315 U.S. at 460. That rule squarely applies to this case. Moreover, this Court in *Langley* recognized, based on *D'Oench, Duhme*, that the term "agreement" in Section 1823(e) should not "be interpreted so much more narrowly than its permissible meaning as to disserve the principle of the leading case applying that term to FDIC-acquired notes" (108 S. Ct. at 402). The same principle applies to the proper construction of the phrase "right, title or interest" in Section 1823(e): consistent with their permissible meaning, those words were properly construed by the court of appeals to ensure that Section 1823(e) precludes a defense squarely covered by *D'Oench, Duhme.*

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[7] Accordingly, contrary to petitioner's argument (Pet. 6-7), the decision of the court of appeals does not undermine or conflict with the law of Texas.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JULY 1989

☆ U.S. GOVERNMENT PRINTING OFFICE: 1989—241-699/00330